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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 409

**HENRY C. RIELY AND ROBERT T. BARTON, JR., AS
RECEIVERS OF PIERCE OIL CORPORATION, A VIR-
GINIA CORPORATION, HERETOFORE DISSOLVED,
PETITIONERS**

v.

THE UNITED STATES OF AMERICA

**ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE FOURTH
CIRCUIT**

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 9-15) are reported at 77 F. Supp. 273. The opinion of the Court of Appeals (R. 20-26) is reported at 169 F. 2d 542.

JURISDICTION

The judgment of the Court of Appeals was entered on August 17, 1948 (R. 26). The petition for a writ of certiorari was filed on Novem-

ber 12, 1948. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTION PRESENTED

Did the Court of Appeals err in holding that taxpayer, a deficit corporation but one which had net earnings for 1937, was not prohibited by Virginia statute from declaring and paying dividends during that year, and, accordingly, was not entitled to a credit under Section 26 (c) (3) of the Revenue Act of 1936, as amended by Section 501 (a) (2) of the Revenue Act of 1942, in computing the surtax on undistributed profits?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) [As amended by Section 501 (a) (2) of the Revenue Act of 1942, c. 619, 56 State. 798] *Restrictions on Payment of Dividends—*

* * * * *

(3) *Deficit corporations.*—In the case of a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year, the amount of such deficit, if the corporation is prohibited by a provision of a law or of an

order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936.

* * * * *

Virginia Code of 1936, Annotated:

SEC. 3840. *Capital defined; dividends; liability of directors for declaration of dividends.*—The board of directors of every corporation shall, unless otherwise provided in its charter, certificate of incorporation or articles of association, or in any amendment thereto, have power to declare and pay dividends upon the shares of its capital stock out of net earnings, or out of its net assets in excess of its capital as hereinafter defined. The capital of a corporation shall be the sum of the consideration received by the corporation in payment for its shares of stock, whether with or without nominal or par value, plus such amounts as from time to time by resolution of the board of directors may be transferred to capital and/or less such amounts as may be transferred from capital by a reduction thereof, pursuant to the provisions of section thirty-seven hundred and eighty-one, and shall not include contributed surplus when, under the terms and conditions of the subscription agreement to any shares of stock, it is provided that in addition to the consideration paid for such stock, there shall be paid by the subscriber a sum to be contributed surplus of the corporation. No dividend

shall be paid, in whole or in part, from contributed surplus upon any shares of stock without written notice being given to stockholders receiving the same, at the time of payment of any such dividend.

If the board of directors declare and pay a dividend out of any part of the capital, as hereinbefore defined, all members of the board who shall be present and know that such dividend is declared in violation of this section, and shall not dissent therefrom, shall, in their individual capacity, be jointly and severally liable to the corporation's creditors for the amount of such dividend so unlawfully paid and may be proceeded against therefor on a bill in equity filed on behalf of such creditors and, moreover, each stockholder who participates in such dividend shall be liable to such creditors to the extent of such dividend unlawfully paid so received by him.

Treasury Regulation 94, promulgated under the Revenue Act of 1936:

ART. 26-2 [As amended by T. D. 5263, 1943 Cum. Bull. 1003]. *Credit in Connection with Restrictions on Payment of Dividends.*—

* * * * *

(d) *Deficit corporations.*—Under the provisions of section 26 (c) (3), a corporation having a deficit in accumulated earnings and profits as of the close of the preceding taxable year is allowed as a credit

the amount of such deficit to the extent that the corporation is prohibited by a provision of a law or of an order of a public regulatory body from paying dividends during the existence of a deficit in accumulated earnings and profits, and if such provision was in effect prior to May 1, 1936.

* * * * *

* * * In addition the taxpayer must show, under a law or an order of a public regulatory body, the extent to which it could not legally have paid dividends during the existence of such deficit. * * *

STATEMENT

The stipulated facts, found by the District Court, may be summarized as follows:

Taxpayer, a Virginia corporation, was organized on June 21, 1913, and dissolved by decree of the Circuit Court of the City of Richmond, Virginia, entered December 27, 1940. In April, 1940, Henry C. Riely and Robert T. Barton, Jr., were appointed receivers of the taxpayer by order of the court. Henry C. Riely resigned as a receiver on May 4, 1945, and Robert T. Barton, Jr., continued as sole receiver by decree of the court. (R. 10-11.)

For a number of years preceding the taxable year, 1937, taxpayer's operations had been unsuccessful, and it had sustained a deficit in accumulated earnings and profits up to and including December 31, 1936, of at least \$1,149,-

642.76. Taxpayer had net earnings and profits for 1937 of \$86,412.46, no part of which was distributed during the year 1937. At the close of the year 1936 and during the entire year 1937, it had a deficit in accumulated earnings and profits and the taxpayer's capital was impaired on December 31, 1936, by at least \$1,149,642.76 and, on December 31, 1937, by at least one million dollars. (R. 13.)

In March 1938, the taxpayer filed its federal income tax return for the taxable year 1937 and paid under protest, in four equal installments, the undistributed profits tax shown to be due thereon in the total amount of \$17,714.55 (R. 12).

On or about January 13, 1943, the receivers filed with the Collector a claim for refund of \$17,714.55 paid as an undistributed profits tax for 1937. After more than six months had elapsed without action on the claim by the Commissioner, taxpayer brought the instant suit. (R. 13-14.)

The District Court entered judgment for the taxpayer (R. 15-17). The Court of Appeals for the Fourth Circuit reversed, holding that the Virginia statute did not prohibit the declaration of dividends by a deficit corporation of the net earnings for the current year (R. 20-26).

ARGUMENT

The question resolved by the decision below is whether Section 3840 of the Virginia Code, *supra*,

pp. 3-4, prohibited taxpayer from declaring and paying as dividends \$86,412.46 in net earnings for 1937 (R. 13), so as to entitle it to a credit under Section 26 (c) (3) of the Revenue Act of 1936, as amended by Section 501 (a) (2) of the Revenue Act of 1942, *supra*, pp. 2-3,¹ in computing the surtax on undistributed profits imposed by Section 14 of the Revenue Act of 1936. The court below, in a thorough and well-reasoned opinion, which, we think, reached the correct result, concluded that, notwithstanding that taxpayer was a deficit corporation, Section 3840 of the Virginia Code was no barrier to a declaration of dividends in 1937 out of 1937 net profits, since that section provides for the payment of dividends "out of net earnings, or out of its net assets in excess of its capital" (R. 20-26). The court emphasized that two distinct sources of dividends are provided, and pointed out that to conclude that "net earnings" of a given year are not a permissible source of dividends requires the addition of a provision not in the statute to the effect that net earnings may not be used if capital is impaired (R. 22-23). The court further emphasized the permissive rather than prohibitory nature of the statute and the authoritative definitions of "net

¹ That section as amended has already been interpreted by this Court in a different connection. *United States v. Ogilvie Hardware Co.*, 330 U. S. 709.

earnings" as connoting earnings of a given period.²

There is no decision by the Supreme Court of Virginia or any inferior court of Virginia directly or indirectly interpreting Section 3840 of the Virginia Code.³ In the absence of such authority, the decision of the United States Court of Appeals for the Fourth Circuit, which includes the State of Virginia, is entitled to great weight. Particularly is this so when the opinion, as here, was written by a judge with many years of experience in Virginia jurisprudence. *Helvering v. Stuart*, 317 U. S. 154, 162-164; *MacGregor v. State Mutual Co.*, 315 U. S. 280, 281.

² The emphasis placed by the receivers on the language of the last paragraph of Section 3840, *supra*, providing joint and several director liability for paying a dividend "out of any part of the capital" (Pet. 12, 17) at most begs the question at issue. In view of the two sources for dividend payment provided by the preceding paragraph, "net earnings" in this statute is obviously not encompassed by the term "capital," nor is it generally. Kehl, *Corporate Dividends* (1941) 63.

³ *Johnson v. Johnson & Briggs*, 138 Va. 487, cited by the receivers in support of their petition (pp. 9, 16) is concededly dictum (Pet. 16), but even the dictum does not support them. The next phrase of the opinion which was omitted from the quotation on page 16 of their petition, that "but they [dividends] must be declared out of earnings * * *" (138 Va. 495), is precisely in accord with the interpretation by the court below. Only when the very point at issue, whether there can be earnings if capital is impaired, is assumed does the dictum of the Virginia court and most of the other citation of authorities marshalled by the receivers support them.

The underlying basis for this petition, that an important question of local law has been incorrectly decided, is a peculiarly inappropriate ground for the issuance of the writ, since this Court has unmistakably expressed its desire to "certainly avoid becoming a Court of first instance for the determination of the varied rules of local law prevailing in the forty-eight states." *Helvering v. Stuart*, *supra*, p. 164. A decision by this Court would be, moreover, at best a tentative resolution of the alleged important question. Cf. *Railroad Comm'n v. Pullman Co.*, 312 U. S. 496, 500.

But even if this case contained a more appropriate issue for the Court's consideration, even the usual grounds in support of the petition are absent here. Not only was the case correctly decided, but there is no conflict with decisions of this Court or other Courts of Appeals. There is no conflict with *Glenn v. Mengel Co.*, 145 F. 2d 235 (C. A. 6), affirming 50 F. Supp. 765 (W. D. Ky.), because that case dealt with a New Jersey statute the provisions of which, as the court below accurately pointed out, are distinguishable (R. 25). *Senior Investment Corp. v. Commissioner*, 2 T. C. 124, interpreting a Michigan statute, presents no ground for certiorari because of the inferior status of the Tax Court decision, particularly where a question of State

law is concerned. Cf. *Helvering v. Stuart*, *supra*, p. 164.

The assertion of conflict with *Mobile & Ohio Railroad v. Tennessee*, 153 U. S. 486, and *Willcuts v. Milton Dairy Co.*, 275 U. S. 215 (Pet. 10), is patent'ly untenable. The former case dealt with an entirely different situation. The definition of "net earnings" in the opinion (p. 497), as the court below accurately noted, supports its view of the Virginia statute, and the language quoted in the petition (p. 10) supports the opposite conclusion only if it be assumed that a dividend out of "net earnings" is out of "capital."⁴ *Milton Dairy Co.* dealt with the term "undivided profits" as used in Title III of the Revenue Act of 1918. The observation in that opinion that there could be neither "undivided profits" nor "surplus" while capital was impaired is certainly not relevant to the present inquiry.

CONCLUSION

Since the only question here is one of State law, it cannot be definitively answered by this Court. The decision below is well reasoned,

⁴ See fn. 3, *supra*, where the receivers' predilection for citing authority by assuming the very issue in controversy is discussed in another connection. It is this fundamental logical error that has apparently led to their astonishing contention that (Pet. 11) the court below has "so far departed from the accepted and usual course of judicial proceeding as to call for an exercise of this Court's power of supervision."

seems correct, and conflicts with no decision of this Court or any other Court of Appeals. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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